

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:HMT:CLE:PIT:POSTF-130687-02
MAYost

date: June 12, 2002

to: [REDACTED], Team Manager

from: Associate Area Counsel, LM:HMT:CLE:PIT

subject: TEFRA Status - [REDACTED]
[REDACTED] Audit
UIL # 6231.01-01

This is in reply to your oral request for advice. Our response is conditioned on the accuracy of the facts provided by you.

This memorandum should not be cited as precedent. It is also subject to 10-day post review by the National Office and, therefore, could be modified.

ISSUES

1. Whether [REDACTED] is a small partnership under I.R.C. § 6231(a)(1)(B) for [REDACTED] and [REDACTED] and, therefore, is not subject to the unified TEFRA audit provisions?
2. Whether [REDACTED] can be treated as a TEFRA entity pursuant to I.R.C. § 6231(g)?

CONCLUSIONS

1. [REDACTED] qualifies as a small partnership under I.R.C. § 6231(a)(1)(B).
2. I.R.C. § 6231(g) is not applicable under our facts.

FACTS

For the tax years [REDACTED] through [REDACTED], [REDACTED] (hereinafter "[REDACTED]") filed partnership returns. Based upon Schedules K-1 attached to the returns, [REDACTED] had three partners, each of which was a corporation. [REDACTED], a domestic corporation, had a [REDACTED] % interest in

██████████. Another domestic corporation, ██████████, owned ██████████% of the partnership. The final partner was reported to be a foreign corporation, ██████████, which owned the remaining ██████████% interest.

On its partnership returns for ██████████ and ██████████, ██████████ affirmatively indicated on Schedule B, line 4 that it was subject to the consolidated audit procedures of sections 6221 through 6233. In addition, ██████████ designated ██████████ as its tax matters partner for both tax years. ██████████, though, did not file an election with its partnership returns, as provided under Treas. Reg. § 301.6231(a)(1)-1(b)(1), to opt out of the small partnership exception under I.R.C. § 6231(a)(1)(B).

Subsequently, the examining agent solicited and obtained Forms 872-P for ██████████ covering the partnership years ██████████ through ██████████. The latest consent was signed by ██████████ as TMP and by ██████████ as the parent of the TMP and purportedly extended the statute of limitations for the partnership years ██████████, ██████████ and ██████████ to ██████████.

LAW AND ANALYSIS

Under I.R.C. § 6231(a)(1)(B)(i), small partnerships are not subject to the unified TEFRA audit procedures. A small partnership is defined as one having 10 or fewer partners each of whom is an individual, a C corporation, or an estate of a deceased partner.¹ The determination of whether a partnership meets the requirements for the small partnership exception under § 6231(a)(1)(B) is made with respect to each partnership taxable year. Thus, a partnership that does not qualify as a small partnership in one tax year may qualify as a small partnership in a succeeding tax year if the requirements for the exception are met. Treas. Reg. § 301.6231(a)(1)-1(a)(3). This means that ██████████ can be a small partnership exempted from the TEFRA rules beginning with the tax year ██████████, despite the fact that the small partnership exception was not applicable in prior years.

A small partnership can elect to have the TEFRA provisions apply. I.R.C. § 6231(a)(1)(B)(ii). An election is made by attaching a statement to such effect on the partnership return for the tax year in which the election is to be effective. The statement must be signed by all of the partners. Treas. Reg.

¹ For taxable years ending after August 5, 1997, section 6231(a)(1)(B) was amended to allow C corporations as partners in addition to natural persons.

§ 301.6231(a)(1)-1(b)(2). For any partnership year for which the due date of the return is before January 2, 2002, the partnership may file the election on or before the date which is one year before the expiration of the partnership's statute of limitations under I.R.C. § 6229(a), determined with regard to extensions under I.R.C. § 6229(b).

During the tax years at issue, [REDACTED] had three corporate partners. Two of its partners, [REDACTED] and [REDACTED], were C corporations. A question arises, however, whether [REDACTED], being a foreign corporation, can qualify as a "C corporation" for purposes of the small partnership exception. I.R.C. § 1361(a)(2) is cited by Treas. Reg. § 301.6231(a)(1)-1(a)(1) as providing the definition of a "C corporation". This section states that

For purposes of this title, the term 'C corporation' means, with respect to any taxable year, a corporation which is not an S corporation for such year.

I.R.C. § 1361(a)(2), thus, explicitly defines a corporation that is not an S corporation as a C corporation for "purposes of this title", referring to Title 26 (the Internal Revenue Code). The TEFRA provisions fall within Title 26. Therefore, a foreign corporation that is not a S corporation is a "C corporation" for purposes of the small partnership exception. Accordingly, [REDACTED] qualifies as a C corporation, since it is not an S corporation. And, it follows that [REDACTED], having only three partners, all of which are C corporations, qualifies as a small partnership within the meaning of I.R.C. § 6231(a)(1)(B) beginning with the tax year [REDACTED].

I.R.C. § 6231(g)(1) provides that if, on the basis of a partnership return, the Secretary reasonably determined that TEFRA applied to a partnership, even though such determination was erroneous, then the TEFRA provisions would be extended to both the partnership and its partners for such year. In our case, the issue becomes whether the Secretary could "reasonably" determine, based on the information reported on the [REDACTED] and [REDACTED] returns, that [REDACTED] was subject to TEFRA.

After reviewing the returns, however, we doubt that such an argument can be sustained in our case. First and foremost, the partnership returns reflect that [REDACTED] had only three corporate partners, which is well within the threshold parameters of a small partnership. Further, as discussed above, it does not matter that one of its partners was a foreign corporation. We note that [REDACTED] did answer affirmatively in response to question 4 of Schedule B that it was subject to the unified audit

provisions, and consistent therewith, it did designate a TMP for each year. However, the instructions for Form 1065 indicate that answering "YES" to question 4 does not constitute a valid election to opt out of the small partnership exception. Such election must be made separately and be signed by all of the partners in accord with Treas. Reg. § 301.6231(a)(1)-1(b)(2). Without an election, [REDACTED] remained a small partnership not subject to TEFRA. Its affirmative response to question 4 and its designation of a TMP, thus, is inconsequential. Further, we can not say that it provides a reasonable basis to conclude that TEFRA applies, where the partnership's members as shown per Schedule K-1 attached to the returns reflect that it is a small partnership, absent a contrary election. Finally, the fact that [REDACTED] signed a TEFRA consent on Form 872-P as TMP for [REDACTED] is not a factor under I.R.C. § 6231(g)(1), since the consent is not part of the partnership return.²

Since the small partnership exception applies for [REDACTED] and [REDACTED], the partnership audit for these years should be concluded using NON-TEFRA procedures.³ Adjustments against any partner for [REDACTED] and [REDACTED] are viable to the extent that the partner's individual statute of limitations has been protected. The small partnership exception is not available to [REDACTED] for [REDACTED], so the partnership is subject to the unified TEFRA procedures for this year.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege.

² Since we understand that consents have been executed extending the statute of limitations for [REDACTED] for the years in question ([REDACTED] and [REDACTED]), we do not have to opine whether the forms 872-P executed by it and its parent can be deemed to constitute a restricted consent extending its statute of limitations with respect to the partnership items of [REDACTED].

³ The window provided by Treas. Reg. § 301.6231(a)(1)-1(b) for retroactively electing TEFRA status for [REDACTED] and [REDACTED] is open only to the extent that one year remains on the partnership's statute of limitations for these years. This, in turn, depends, at least for [REDACTED], upon whether all of the partners have executed individual consents pursuant to I.R.C. § 6229(b)(1)(A). The Forms 872-P are not effective to extend the statute of limitations, since [REDACTED] was not subject to TEFRA and there was no TMP empowered to sign on behalf of all of the partners pursuant to I.R.C. § 6229(b)(1)(B).

If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please call Attorney Michael A. Yost, Jr. at (412) 644-3441.

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By: _____
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